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DEPARTMENT OF THE TREASURY

Departmental Offices

Interim Guidance Concerning the Terrorism Risk Insurance Extension Act of 2005.

AGENCY: Department of the Treasury, Departmental Offices

ACTION: Notice.

SUMMARY: This notice provides interim guidance to insurers, policyholders, state insurance regulators and the public concerning recent statutory amendments to the Terrorism Risk Insurance Act of 2002 (Pub.L.107-297, 116 Stat. 2322). In particular, this notice provides interim guidance on the types of commercial property and casualty insurance covered by the Act, the requirements to satisfy the Act's mandatory availability ("make available") provision and on the operation of the new "Program Trigger" provision in section 103(e)(1)(B) of the Act.

DATES: This notice is effective immediately and will remain in effect until superceded by regulations or by subsequent notice.

FOR FURTHER INFORMATION CONTACT: Howard Leikin, Deputy Director, Terrorism Risk Insurance Program or David J. Brummond, Legal Counsel, Terrorism Risk Insurance Program (202-622-6770).

SUPPLEMENTARY INFORMATION:

This notice provides interim guidance to assist insurers and policyholders in understanding certain requirements of the Terrorism Risk Insurance Act of 2002 as amended by the Terrorism Risk Insurance Extension Act of 2005 (Public Law 109-144, 119 Stat. 2660) pending the issuance of regulations by the Department of the Treasury. The interim guidance contained in this notice may be relied upon by insurers in complying with these statutory requirements prior to the issuance of regulations, but is not the exclusive means of compliance. This interim guidance remains in effect until superceded by regulations or subsequent notice.

I. Background

On November 26, 2002, the President signed into law the Terrorism Risk Insurance Act of 2002 (Pub.L.107-297) (TRIA or the Act). The Act became effective immediately. It established a temporary Terrorism Risk Insurance Program (TRIP or the Program) of shared public and private compensation for insured commercial property and casualty losses resulting from an act of terrorism, as defined in the Act. The Act was scheduled to expire on December 31, 2005.

On December 22, 2005, the President signed into law the Terrorism Risk Insurance Extension Act of 2005 (Extension Act), which extends TRIA through December 31, 2007. In doing so, the Extension Act adds Program Year 4 (January 1 – December 31, 2006) and Program Year 5 (January 1 – December 31, 2007) to the Program. In addition, the Extension Act made other significant changes to TRIA that include:

- A revised definition of “Insurer Deductible” that adds new Program Years 4 and 5 to the definition. The insurer deductible is set as the value of an insurer’s direct earned premium for commercial property and casualty insurance (as now defined in the Act) over the immediately preceding calendar year multiplied by 17.5 percent for Program Year 4 and 20 percent for Program Year 5.
- A revised definition of “Property and Casualty Insurance” that now excludes commercial automobile insurance; burglary and theft insurance; surety insurance; professional liability insurance; and farm owners multi peril insurance. Though the definition excludes professional liability insurance, it explicitly retains directors and officers liability insurance.
- Creation of a new “Program Trigger” for any certified act of terrorism occurring after March 31, 2006, that prohibits payment of Federal compensation by Treasury unless the aggregate industry insured losses resulting from that act of terrorism exceed \$50 million for Program Year 4 and \$100 million for Program Year 5.
- A change to the Federal share of compensation for insured losses. Subject to the Program Trigger, the Federal Share is 90 percent of that portion of the amount of insured losses that exceeds the applicable insurer deductible in Program Year 4 and decreases to 85 percent of such amount in Program Year 5.
- Revisions to the recoupment provisions. For purposes of recouping the Federal share of compensation under the Act, the “insurance marketplace aggregate retention amount” for the two additional years of the Program is increased from the level in Program Year 3. For Program Year 4 the “insurance marketplace aggregate retention amount” is established as the

lesser of \$25 billion and the aggregate amount, for all insurers, of insured losses during Program Year 4. The “insurance marketplace aggregate retention amount” for Program Year 5 is the lesser of \$27.5 billion and the aggregate amount, for all insurers, of insured losses during Program Year 5.

- A statutory codification of Treasury’s litigation management regulatory requirements in section 50.82 of title 31 of the Code of Federal Regulations (as in effect on July 28, 2004), which requires advanced approval by Treasury of proposed settlements of certain causes of action involving insured losses under the Program.

II. Interim Guidance

Treasury will be issuing regulations to administer and implement TRIA, as amended by the Extension Act. This notice is issued to assist insurers in complying with certain statutory requirements prior to the issuance of such regulations. This notice contains interim guidance concerning compliance with the mandatory availability or “make available” requirements in section 103(c) of the Act, revisions to commercial lines of property and casualty insurance as defined by section 102(12) of the Act, and the operation of the new Program Trigger in section 103(e) of the Act.

A. Mandatory Availability

Has the “make available” requirement changed?

For Program Year 4 (Calendar 2006) and Program Year 5 (Calendar 2007) insurers are required to continue to “make available” coverage for insured losses as required by TRIA and Treasury regulations. Amendments to the “make available” requirement in section 103(c) of the Act are simply conforming amendments that continue the requirements through Program Years 4 and 5. Thus, insurers issuing or renewing commercial property and casualty insurance policies in Program Years 4 and 5 must continue to offer coverage for insured losses resulting from an act of terrorism as required by section 103(c) of the Act and 31 CFR sections 50.20 to 50.24 for their insured loss claims to be eligible for the Federal share of compensation in the extended Program Years.

Does an insurer have to provide a separate, new offer of terrorism risk insurance coverage on January 1, 2006 or shortly thereafter for property & casualty insurance policies that are now in mid-term if the insurer previously complied with the Act’s “make available” requirement when the policy was issued or renewed in 2005?

No additional “make available” offer is required if terrorism coverage for the duration of the policy term was offered for policies issued or renewed in 2005. No additional action is required because the “make available” provision of section 103(c) of the Act and 31

CFR sections 50.20 to 50.24 has been satisfied for coverage periods extending into Program Year 4. For example, policies with “conditional” terrorism coverage exclusions that do not arise or become effective on or after January 1 are policies in which the terrorism coverage portion continues to cover insured losses within meaning of the Act. In such situations, no additional action is required for insurers to remain in compliance with the Act’s “make available” provision.

What are the “make available” requirements for insurers who issued terrorism coverage that expired on December 31, 2005 but the remainder of the policy continues in force in 2006?

If terrorism coverage was made available and accepted by the policyholder but the terrorism portion of coverage expired on December 31, the insurer must provide the policyholder with a new offer of terrorism coverage pursuant to section 103(c) of the Act and 31 CFR sections 50.20 to 50.24 for the remaining period of coverage for the policy. Ideally, policyholders should be given the offer of terrorism coverage before January 1, 2006. However, Treasury recognizes the late date of passage of the Extension Act and the administrative difficulties this poses for some insurers who otherwise have complied with the “make available” provision in 2005. Treasury expects that all insurers will make a good faith effort to provide policyholders whose terrorism coverage expires as of January 1 with a new offer of terrorism coverage along with the appropriate disclosures by January 1, 2006 or as quickly as possible following that date. In this regard, Treasury considers January 31, 2006 to be the latest reasonable date for offers of coverage to midterm policyholders, barring unforeseen or unusual circumstances. If the January 31 date is not met by an insurer, Treasury will expect the insurer to explain any delay as well as its good faith efforts when submitting a claim for the Federal share of compensation under the Program. In its discretion, Treasury will determine whether good faith efforts to comply have been made.

What if terrorism coverage with an expiration of December 31, 2005 was offered and rejected by a policyholder in 2005; must an insurer that offered such coverage renew its offer of terrorism coverage for the remaining term of a policy that extends into 2006?

The Extension Act makes no changes to the “make available” requirement for insurers. However, if an insurer met its “make available” obligation by offering terrorism coverage that expired on December 31, 2005 for a policy otherwise extending into 2006, no further “make available” requirement will be expected of insurers during the remaining 2006 term of that policy if the offer of terrorism coverage was rejected by the policyholder at policy issuance or renewal in 2005. The insurer must nevertheless make an offer of terrorism coverage and appropriate disclosures at time of policy renewal in 2006.

What if a policy renewal or application was processed in 2005 for coverage becoming effective in 2006 and the insurer did not “make available” terrorism coverage for Program Year 4 as contemplated by the Extension Act?

The Extension Act makes no changes to the “make available” requirement for insurers under TRIA. If an insurer wishes to receive Federal compensation under the Program for insured losses, the insurer must “make available” terrorism coverage for insured losses for all policies becoming effective in 2006, even if the policy was processed in late 2005 or early 2006. However, as noted above, Treasury is mindful of the late date of the passage of the Extension Act. Treasury expects that all insurers will make a good faith effort to provide policyholders an offer of terrorism coverage and appropriate disclosures as quickly as possible following January 1, 2006 in circumstances where commercial property and casualty insurance coverage was processed in 2005 to become effective on or after January 1, 2006. As noted above, Treasury considers January 31, 2006 to be the latest reasonable date for offers of coverage, barring unforeseen or unusual circumstances. If the January 31 date is not met by an insurer, Treasury will expect the insurer to explain any delay as well as its good faith efforts when submitting a claim for the Federal share of compensation under the Program. In its discretion, Treasury will determine whether good faith efforts to comply have been made.

May an insurer still use NAIC Model Disclosure Forms to meet the disclosure requirement for property and casualty insurance policies with coverage extending into 2006 or for policies issued, purchased or renewed early in 2006?

Pursuant to 31 CFR section 50.17, insurers are permitted to use NAIC Model Disclosure Forms that were in existence on April 18, 2003 to satisfying the disclosure requirements of section 103(b)(2) of the Act. Although the Extension Act made no change to the requirements for clear and conspicuous disclosure to policyholders of the premium charges for insured losses covered by the Program and of the Federal share of compensation for insured losses under the Program, revisions were made to the Act that may require rewording of the NAIC Model Disclosure Forms. It is Treasury’s intention that an insurer may continue to use the NAIC Model Forms until such time that Treasury-endorsed revised forms are issued by NAIC. Future rulemaking by Treasury will be initiated to provide insurers with a safe harbor in satisfying the disclosure requirement of the Act if the insurers use the latest available NAIC Model Disclosure Forms.

B. Property and Casualty Insurance

How will Treasury determine the types of property and casualty insurance that were recently excluded from the Program?

Section 102(12) of the Act was amended by adding types of insurance that are now excluded from the definition of property and casualty insurance under the Program. To

the extent the new exclusions represent specific lines of business as used on the NAIC Annual Statement, Treasury will continue to utilize NAIC line of business definitions to determine coverage and premium issues in implementing the Act. The newly excluded lines of business from the NAIC Annual Statement include: Line 3 – Farmowners Multiple Peril; Line 19.3 – Commercial Auto No-Fault (personal injury protection); Line 19.4 – Other Commercial Auto Liability; Line 21.2 – Commercial Auto Physical Damage; Line 26 – Burglary and Theft; Line 24 – Surety; and Professional Liability Insurance as reported on Line 17 – Other Liability (see below).

What about types of insurance that are excluded from the definition of property and casualty insurance but are not specific lines of business on the NAIC Annual Statement?

The only type of insurance that is newly excluded from the Act, but is not a specific line of business on the NAIC Annual Statement, is new subsection 102(12)(xi) – professional liability insurance. Until Treasury issues regulations or provides further guidance on the meaning of the definition of “professional liability insurance”, insurers should use the following definition for what constitutes professional liability insurance:

Coverage available to pay for liability arising out of the performance of professional or business duties related to an occupation, with coverage being tailored to the needs of the specific occupation. Examples include abstracters, accountants, insurance adjusters, architects, engineers, insurance agents and brokers, lawyers, real estate agents and stockbrokers.

This interim definition is derived from the definition of “Professional Errors and Omissions Liability” found in the Uniform Property & Casualty Coding Matrix currently utilized by the System for Electronic Rate and Form Filing (SERFF) sponsored by the National Association of Insurance Commissioners (NAIC).¹ Insurers should use this definition in identifying policies excluded from the Program, as well as for determining policies whose premiums should be subtracted from Line 17 – Other Liability on the NAIC Annual Statement when computing direct earned premium for Program purposes. Directors and officers liability insurance, which is sometimes considered a type of professional liability insurance, is not included in the definition as discussed in the next section.

What is the effect of adding the definition of “directors and officers liability insurance” to the definition of “property and casualty insurance” in section 102(12) of the Act?

The explicit addition of this type of insurance to section 102(12) does not substantively modify the previous definition of property and casualty insurance under the Act, but is a statutory clarification that directors and officers liability insurance is distinct from

¹ The Matrix can be found on the NAIC website at http://www.naic.org/industry_home.htm.

professional liability insurance. Premium for directors and officers liability insurance is already included in Line 17 – Other Liability on the NAIC Annual Statement, one of the commercial lines of business under Treasury’s previous regulations defining property and casualty insurance (31 CFR section 50.5(l)). Treasury recommends that insurers consult the definition of “Directors & Officers Liability” found in the Uniform Property & Casualty Coding Matrix now being utilized by SERFF if further guidance is needed on what constitutes “Directors & Officers Liability”.

C. Program Trigger for Federal Share/Certification of Act of Terrorism

How does the Program Trigger for the Federal share of compensation work and how does it coordinate with the Secretary’s certification of an act of terrorism?

The Extension Act adds a new section 103(e)(1)(B) to TRIA entitled “Program Trigger.” This new provision directs the Secretary not to compensate insurers under the Program unless the aggregate industry insured losses from a certified act of terrorism exceed certain insured loss or “trigger” amounts.²

The Extension Act has essentially introduced the concept of a “Program Trigger event” to TRIA. A “Program Trigger event” is a certified act of terrorism occurring after March 31, 2006 in which the aggregate industry insured losses resulting from the event exceed the applicable trigger amount (\$50 million in 2006 and \$100 million in 2007).

The new Program Trigger provision does not apply to acts of terrorism occurring on or before March 31, 2006. The Trigger will apply to such acts that occur after March 31, 2006. Note that the application of the Trigger is based on the date of occurrence and not the date of certification of an act of terrorism. For example, the Program Trigger shall *not* apply to an act that occurs prior to March 31, 2006, but which is later certified after March 31.

After March 31, unless an act of terrorism is a Program Trigger event, insured losses from that act of terrorism will not be considered in any determination of or calculation leading to any Federal share of compensation under the Act.

Treasury is considering whether further rulemaking or guidance is necessary to address issues associated with the new Program Trigger, including whether any adjustments are necessary to reflect the potential difference between acts that are certified under the Program and not eligible for compensation and acts that are certified and eligible for

² Section 103(e)(1)(B) states: “In the case of a certified act of terrorism occurring after March 31, 2006, no compensation shall be paid by the Secretary under subsection (a), unless the aggregate industry insured losses resulting from such certified act of terrorism exceed – (i) \$50,000,000, with respect to such insured losses occurring in Program Year 4; or (ii) \$100,000,000, with respect to such insured losses occurring in Program Year 5.”

compensation under the Program. In terms of TRIA's "make available" requirement contained in Section 103(c) and Subpart C of the regulations, insurers should continue to make coverage available for insured losses, although further consideration of issues posed by the new Program Trigger could affect this requirement on a going forward basis.

What losses of an insurer count towards satisfaction of the insurer deductible and how will the Federal share of compensation be determined?

In Program Year 4, only an insurer's insured losses resulting from certified acts of terrorism occurring between January 1 and March 31, 2006, and the insurer's insured losses resulting from Program Trigger events after March 31, will count towards satisfaction of the insurer deductible. Pursuant to section 103(e)(1)(A) of the Act, the Federal share of compensation will be based on 90 percent of the amount of such insured losses in excess of the insurer deductible.

In Program Year 5, only an insurer's insured losses resulting from Program Trigger events occurring in that year will count towards satisfaction of the insurer deductible. Again, pursuant to section 103(e)(1)(A), the Federal share of compensation will be based on 85 percent of the amount of such insured losses in excess of the insurer deductible.

Treasury will be issuing forms changes and issuing further guidance and rulemaking as necessary to accomplish this compensation payment scheme.

How will Treasury determine and notify insurers that the Program Trigger has been met?

The manner in which Treasury determines whether the Program Trigger has been met will be similar to the process for determining aggregate insured loss amounts in connection with the certification of an act of terrorism. Treasury would contact industry statistical reporting agencies and others to ascertain aggregate industry insured losses. Once the Program Trigger amount has been exceeded, Treasury would notify insurers through press release, notice in the Federal Register and postings on the TRIP website. This determination may be concurrent with the certification of the act of terrorism.

Dated: December 29, 2005

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